

## ILLINOIS COMMERCE COMMISSION

DOCKET 01-0432

## SURREBUTTAL TESTIMONY OF LEONARD M. JONES

NOVEMBER 14, 2001

I. Introduction and Purpose of Testimony

1

2 1. Q. Please state your name, business address, and present position.

3 A. Leonard M. Jones, 500 South 27th Street, Decatur, Illinois 62521. I am Director -  
4 Business Planning and Forecasting for Illinois Power Company.

5 2. Q. Have you previously submitted testimony and exhibits in this proceeding?

6 A. I previously submitted IP Exhibits 6.1 through 6.13.

7 3. Q. What additional evidence are you submitting at this time?

8 A. I am submitting IP Exhibit 6.14 which is my surrebuttal testimony, along with IP Exhibit  
9 6.15, which was prepared under my supervision.

10 4. Q. What is the purpose of your surrebuttal testimony?

11 A. The purpose of my rebuttal testimony is to respond to portions of the direct testimony of  
12 Staff witnesses Lazare and Haas, IIEC witnesses Stephens and Phillips, and People of  
13 the State of Illinois ("AG")/Citizens Utility Board ("CUB") witness Smith concerning  
14 billing determinants and rate design issues.

15

II. Billing Determinants16 5. Q. IIEC witness Phillips states that he believes that IP Ex. 6.8 is more accurate than IP Ex.  
17 6.4, but there is not adequate time to verify all the results of the corrections, changes

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IP Exhibit No. 6.14Witness \_\_\_\_\_  
Date 11/30/01 Reporter CL

18 and updates. (IIEC Ex. 6, pp. 13-14) Please comment.

19 A. The change in billing demands (from 12 month maximum demands to monthly maximum  
20 demands) was the largest change to the billing determinants, and had the largest impact  
21 on the "present" revenue calculation (as shown in IP's response to IIEC Data Request  
22 Item Number 143, Attachment 143-1, which I have included as IP Exhibit 6.15). This  
23 single change represents \$10.3 million of the \$10.9 million change to present revenues,  
24 or nearly 95% of the revenue impact, resulting from all the billing determinant changes.  
25 Similar values were presented in the response to IIEC Data Request Item 81, which  
26 was sent to IIEC on September 26, 2001. Other changes to the billing determinants  
27 were minor in comparison, and by themselves may not have warranted any change at  
28 all. In short, the change in the billing demands explains virtually all of the revenue impact  
29 resulting from the corrections to billing determinants. The last change to billing  
30 determinants was as a result of accepting Mr. Effron's adjustment to billing  
31 determinants. I would also like to note that the billing demand change did not impact  
32 the ECOSS presented by IP witness Althoff.

33 6. Q. Mr. Phillips states that "IP Exhibit 6.8 contains lower per unit rates for most elements of  
34 the over 1,000 kW segment of the demand metered rate class compared to IP Exhibit  
35 6.4. However, the percentage increase for the demand metered class on IP Exhibit 6.8  
36 is approximately three times as large as the stated percentage increase on IP Exhibit  
37 6.4, even though the per unit rates are lower. This anomaly is not explained by witness  
38 Jones" (IIEC Ex. 6, p. 15). Please respond.

39 A. The primary reason for the difference between the percentage increase identified in IP

Exhibit 6.4 and the percentage increase identified in IP Exhibit 6.8 is the change in present revenue caused by the correction to billing demands. As discussed above, the error in billing demands caused present revenue to be \$10.3 million too high, which understates the difference from "proposed" revenue in the calculation of a percentage change. In addition, this also understates the denominator used to calculate the percentage change. Further, a comparison of IP Exhibit 6.4 to IP Exhibit 6.8 (as shown in IP Exhibit 6.15) shows that the difference in proposed revenue for the non-residential demand metered customer group is ~~\$2.2~~<sup>1.9</sup> million, or 2.3%, higher than that proposed in our direct filing. Thus, the proposed revenue requirement target for this class has not changed significantly from the June 1 filing. Further, the difference in proposed revenue for demand metered customers 1,000 kW and over is ~~\$1.9~~<sup>2.2</sup> million, or 12.7%, less in rebuttal (IP Ex. 6.8) compared to direct (IP Ex. 6.4). Finally, the reason for the lower rates for most rate elements was explained in my rebuttal testimony (IP Exhibit 6.6, pp. 10-13). In essence, rather than eliminating a subsidy provided by the smaller demand metered customers to the large demand metered customers, the Company has proposed in rebuttal to continue the subsidy, but to a lesser degree than what is provided under current rates.

7. Q. Mr. Lazare also raises a concern about the number of changes to the billing determinants, and seeks to direct the Company to provide a full explanation of, and support for, proposed billing determinants in its next rate proceeding. (Staff Ex. 14.0, page 26) Please respond.

A. As discussed above, the most significant change to the billing determinants was the

62 correction in the billing demands used for the demand charge from 12 month maximum  
63 demands to monthly maximum demands. Other changes to the billing determinants  
64 were minor in comparison, and by themselves may not have warranted any change at  
65 all. As for Mr. Lazare's request for an explanation of the proposed billing determinants  
66 in its next rate proceeding, the Company would not object. The Company did provide  
67 billing determinant workpapers to Staff in response to Staff Data Request AD-01  
68 shortly after the Company's direct filing on June 1.

69 **III. Rate Design**

70 8. Q. Please respond to Mr. Lazare's statement that the Company should have explained the  
71 non-residential rate design in direct testimony. (Staff Ex. 14.0, p. 22)

72 A. First, I note that Mr. Lazare does not really quibble with my presentation substantively.  
73 Rather, he seems to wish merely that I had presented it earlier. Save for a few changes  
74 that reflect my agreement with certain Staff and Intervenor Testimony, however, none of  
75 the information provided in rebuttal was new. This information could have been  
76 obtained from the Company's responses to data requests and our workpapers. To the  
77 extent Mr. Lazare still was unsure of our methodology, he could have asked clarifying  
78 questions. He apparently did none of this. All this said, IP is willing to provide a similar  
79 write-up in its direct case in subsequent rate cases.

80 **A. Residential Rates**

81 9. Q. What comments have Staff and intervenor witnesses made regarding the residential rate  
82 design described in your rebuttal?

83 A. Both Mr. Lazare and Ms. Smith accept the Company's proposed facilities charges, but

84 there continue to be differences on the structure of the delivery charge. Ms. Smith  
85 proposes a different two block delivery charge, while Mr. Lazare proposes a flat  
86 delivery charge. (Staff Ex. 14.0, p. 18; AG/CUB Ex. 3, pp. 3-4)

87 10. Q. Ms. Smith claims that the Company proposes to implement winter and summer price  
88 differentials in the pricing of the residential delivery charge. Is this correct?

89 A. No. The Company's proposal, which modifies Ms. Smith's proposal from Direct,  
90 seeks to use a single, load-weighted price differential of 1.4 cents/kWh as discussed on  
91 page 6 of my rebuttal testimony. In her direct testimony, Ms. Smith stated that "the  
92 price differential between the block rates, should be the same in the delivery service rate  
93 and the bundled rates" (AG/CUB Ex. 1, p. 20), and that "current rates also have two  
94 blocks, with the same block sizes, but the rate reduction from the first to the second  
95 block is only \$.0085". (AG/CUB Ex. 1, p. 11). It appeared that Ms. Smith  
96 overlooked the winter rate differential in her direct testimony. Now that the winter rate  
97 is recognized, Ms. Smith seems to move away from her original proposal, and holds fast  
98 to a differential of only \$0.008, which is equal to the 4 month summer billing season  
99 bundled rate differential. It should be noted that while the Company's proposed 1.4  
100 cent/kWh delivery charge differential is larger than what the Company originally  
101 proposed and is higher than the "cost based" differential, the proposed Facilities  
102 Charges are below cost for multi and single family service (by \$1.17/month or 16.4%  
103 and \$0.29/month or 3.5%, respectively), and above cost for three-phase service (by  
104 \$2.66/month or 19.9%). Thus, on balance, the total rate design produces results close  
105 to the cost basis, with a bias toward above cost Facilities Charge being charged to the

larger residential customer (i.e. those more likely to be served by three-phase service).

The first block of the delivery charge may be slightly above cost for the small use customers, but the Facilities Charge that would apply to these customers are below cost.

11. Q. Has Mr. Lazare offered arguments that persuade you not to use a declining block rate for the residential delivery charge?

A. No. First, Mr. Lazare ignores Ms. Smith's reason for proposing a declining block delivery rate. Ms. Smith testifies that rate impacts will be minimized if the rates are similar to bundled rates (AG/CUB Ex. 1, p. 14). Specifically, she recommends that "the rate design, that is the customer charge and the price differential between the block rates, should be the same in the delivery service rate and the bundled rates". (AG/CUB Ex. 1, p. 20)

Second, Mr. Lazare criticizes the Company's hypothetical example provided in IP Exhibit 6.12. Mr. Lazare questions whether the scenarios represent the actual costs incurred on the IP system. The use of the designs at 300 kWh and 3,000 kWh were in response to Mr. Lazare's example on page 38 of Staff 5.0, where he stated that "it would be reasonable to assume that a customer using 3,000 kWh per month would require larger secondary facilities than a customer using 300 kWhs per month". IP Exhibit 6.12 was presented to show that while the total cost to serve the 3,000 kWh/month customer is indeed higher, on a cost per kWh basis, the smaller customer is more expensive to serve. A typical customer would use less than 1,350 kWh/month (85% of IP residential customers use less than this amount). For these customers, the

128 facilities used to serve the 300 kWh customer would be adequate, with the exception of  
129 the need for the next largest transformer, resulting in an increase in cost of \$168, or  
130 \$0.00027 per kWh (assuming 1,000 kWh/month). While there is some difference in  
131 total costs for the hypothetical examples, the costs for the few groups within the  
132 residential class are fairly homogeneous.

133 12. Q. What about the other factors that Mr. Lazare mentions, such as that the smaller usage  
134 group potentially includes a higher percentage of apartment dwellers and mobile home  
135 residents who are closer in proximity, or that larger-use consumers presumably live in  
136 less densely spaced dwellings and because of their distance from other customers may  
137 need more secondary facilities? (Staff Ex. 14.0, p. 19)

138 A. These factors do not warrant a flat Delivery Charge. The examples I have provided  
139 indicate that the cost of providing "secondary" service is predominantly fixed in nature.  
140 Under a flat rate structure, the cost of secondary facilities would be recovered from all  
141 customers on a uniform average rate per kWh. The following data will illustrate the  
142 inappropriateness of this rate structure. Using data from IP Exhibit 6.10, schedule 2,  
143 item 1, page 7, the average cost per kWh of residential secondary is \$0.00296/kWh  
144 (\$15.45 million / 5.215 billion kWh). A 300 kWh/month customer would pay  
145 \$10.66/year for secondary facilities under Mr. Lazare's proposal. Similarly, a 3,000  
146 kWh/month customer would pay \$106.65/year for secondary facilities under a flat rate.  
147 Yet, as demonstrated in IP Exhibit 6.12, the costs of serving a group of customers with  
148 small loads compared to serving a group of customers with the larger loads do not  
149 move in lockstep with the increased consumption. The incremental cost of providing

150 service is not equal to the average cost per kWh. Further, it is not typical to serve 6  
151 customers from a 10 kVA transformer. The average is only 1.2 customers. Thus, the  
152 typical cost to serve small customers may very well be higher than that shown in IP  
153 Exhibit 6.12.

154 13. Q. Is there a rate-making inconsistency, as Mr. Lazare contends, by using the Company's  
155 approach (i.e., recovery of secondary costs in an initial block)?

156 A. While secondary costs are allocated based on maximum demands to the various rate  
157 groups in the ECOSS, it does not change the fact that secondary costs for residential  
158 customers predominantly consist of the costs to connect the customer to the system  
159 regardless of his/her actual load.

160 Also, for residential and small commercial customers, distribution planners often  
161 do not know the exact load size that the customers will be. Default assumptions are  
162 used that tend to give rise to a system whose costs per customer are closer to a class  
163 average.

164 14. Q. Ms. Smith also continues to argue against using the secondary voltage costs as the basis  
165 for a Delivery Charge rate differential by listing a series of objections. She states that IP  
166 Exhibit 6.12 is extremely hypothetical, has questionable assumptions, does not appear  
167 to represent typical distribution facilities, and does not justify IP's position on rate  
168 design for recovery of local distribution costs. (AG/CUB Ex. 3, pp. 4-6) Please  
169 respond.

170 A. As discussed above, IP Exhibit 6.12 shows the costs for hypothetical customers based  
171 on Mr. Lazare's example provided in his direct testimony. Nevertheless, the exhibit is



intended to show two extremes. If the exhibit were revised to demonstrate the cost of an "average" or "typical" design, or set of designs, it would lead to the same conclusion: the cost of residential secondary voltage systems is not significantly driven by demand (as measured in cents/kWh), and the cost of serving various customer groups is not significantly different (as measured in cents/kWh). Also, it would be impractical for residential rate design to attempt to fit every unique possibility. Rather, it is more reasonable to develop rates that fit the majority of customers.

**B. Small Use General Service**

15. Q. Mr. Lazare also opposes a declining block delivery charge for Small Use General Service customers, for the same reasons discussed above for residential customers. (Staff Ex. 14.0, p. 23) Please respond.

A. The average Small Use General Service customer uses less than the average residential customer, and under the tariff definitions cannot use more than 61 kWh per day in a summer billing month. Also, these customers are businesses, and therefore have less potential to share facilities than the residential class. As a result, these customers tend to be even more homogeneous than residential customers. Thus, the reasons that support using a declining block delivery charge for the residential class are even stronger with respect to the Small Use General Service customers.

16. Q. What facilities and metering charge has Mr. Lazare proposed for the Small Use General Service customer?

A. An examination of Staff Exhibit 14.4 indicates that Mr. Lazare for the most part appears to follow the Company's recommended metering charges. However, Mr. Lazare's

194 proposed facilities charges are based on the single and three phase service relative to  
195 the total facilities revenue proposed by the Company, but scaled back to a level below  
196 the Company's facilities cost of service. Should the Commission decide to use cost-  
197 based rates for facilities charges, these rates are present on IP Exhibit 6.10, schedule 2,  
198 item 1, page 5, column 6. Mr. Lazare's proposed facilities charges maintain the relative  
199 relationship to the Company's proposed prices, but do not maintain the relationship to  
200 the Company's costs. The reasons for the Company proposing rates that slightly  
201 deviate from cost are discussed in my rebuttal testimony in Answer 22. Mr. Lazare has  
202 offered no reason why the Company's proposal should not be accepted, and even  
203 concludes that the Company's proposed rates "provide more reasonable rate continuity  
204 with the existing rate delivery services rate design and the rate design for bundled  
205 service." (Staff Ex. 14.0, p. 22) Mr. Lazare's proposed facilities charges do not  
206 provide the same degree of rate continuity as the Company's proposed facilities  
207 charges, and should be rejected in favor of the Company's proposal.

208 **C. Demand Metered General Service**

209 17. Q. What facilities and metering charge has Mr. Lazare proposed for the Demand Metered  
210 General Service customer?

211 A. An examination of Staff Exhibit 14.5 indicates that Mr. Lazare takes the Company's  
212 facilities charges proposed in rebuttal and scales the values down by a uniform  
213 percentage to arrive at a value that is just below the embedded cost of service (i.e., his  
214 rates recover \$7.6 million versus cost of service of \$8.2 million). As with Small Use  
215 General Service customers, should the Commission decide to use cost-based rates for

216 Demand Metered General Service facilities charges, these rates are present on IP  
217 Exhibit 6.10, schedule 2, item 1, page 5, column 6. The Company's cost-based rates  
218 take into account the cost contribution of each service level or type. Mr. Lazare's  
219 proposed facilities charges for this class maintain the relative relationship to the  
220 Company's proposed prices, but do not maintain the relationship to the Company's  
221 costs.

222 For customers over 200 kW, Mr. Lazare appears to use the same approach as  
223 for the facilities charge discussed above to generate his proposed metering charges. For  
224 demand metered customers below 200 kW, his schedule 14.5, page 1 of 4, indicates  
225 that the existing metering charges appear to be scaled to meet the target revenue level  
226 rather than the Company's proposed rates. This appears to be an oversight, since it is  
227 inconsistent with his development of the metering charge for the other demand metered  
228 customers. As with the Facilities Charge, Mr. Lazare's Metering Charges recover an  
229 amount that is different from cost (\$5.9 million vs. costs of \$5.5 million (see IP Exhibit  
230 6.10, schedule 2, item 2, page 4)). In any event, the Company's proposed rates should  
231 be used. The Company's rates will provide a smoother transition for customers as the  
232 individual demand metered facilities charges are moved to cost of service.

233 18. Q. Do you have any comments on Mr. Lazare's proposed demand charges shown in Staff  
234 Schedule 14.5?

235 A. Mr. Lazare, for the most part, appears to accept the Company's proposed demand  
236 charges, with some minor modifications. However, I am concerned that Mr. Lazare's  
237 modifications do not properly consider the revenue relationship with other charges such

238 as the Reactive Demand Charge. If modifications to the Company's rate elements are  
239 needed, they should follow the methodology outlined in IP Exhibit 6.10.

240 19. Q. What is Mr. Lazare's proposed rate for the Reactive Demand Charge?

241 A. Mr. Lazare increases the rate from \$0.10 per kVAR to \$0.102/kVAR despite cost  
242 evidence indicating the charge should be higher. For the reasons discussed later in  
243 response to Mr. Stephens, and in earlier testimony, the reactive demand charge should  
244 be as IP proposed: \$0.20/kVAR.

245 20. Q. Does Mr. Lazare accept the distribution capacity charge as proposed by the Company?

246

247 A. No. Mr. Lazare's Schedule 14.5 takes the revenue that the Company proposed to  
248 recover through the distribution capacity charge and instead increases the price for the  
249 primary voltage demand charge.

250 21. Q. Does Mr. Lazare respond to your arguments presented in rebuttal testimony concerning  
251 the distribution capacity charge?

252 A. Mr. Lazare responds to the distribution capacity example presented in IP Exhibit 6.13  
253 by stating that it is based on the faulty premise that the only demands that matter from a  
254 distribution standpoint are the peak demands of individual customers, and that this  
255 argument fails to consider the benefits of demand diversity. He further contends that a  
256 low load factor customer may not tax the distribution system if that customer peaks at a  
257 different day or month from other distribution customers, while this potential benefit may  
258 not exist for a high load factor customer with a constant distribution demand. (Staff Ex.  
259 14.0, p. 25)

260           The problem with Mr. Lazare's argument is that while exceptions may exist,  
261           they are not common. It would be far more common for customers on a primary  
262           voltage circuit to behave similarly. For example, a shopping mall would likely peak at  
263           or near the same time that a neighboring Toys R Us would peak, even if one had a  
264           different load factor than the other. Indeed, most of the Company's demand metered  
265           primary voltage load consists of commercial customers, whose peaks are driven  
266           primarily by air conditioning load. The example in IP Exhibit 6.13 highlights the benefit  
267           of pricing using the distribution capacity charge, and likewise shows the limitations of  
268           using the monthly maximum demand, namely, the potential for the higher load factor  
269           customer to subsidize the low load factor customer is much greater.

270    22.    Q.    Do you have any further comments on Mr. Lazare's proposed demand charges?

271           A.    Yes. The Staff proposed charge on Schedule 14.5, page 3 of 4, for the standby  
272           capacity requirement for primary voltage customers should be identical to the price for  
273           the demand charge at the same voltage level. I believe that as currently stated on  
274           Schedule 14.5, it is in error. Also, the "Annual Revenue" shown to be generated by  
275           "Staff Proposed Charges" for the Demand Charge shown in Schedule 14.5, page 3, are  
276           about \$626,000 too high (or the "Proposed Charges" are too low). In any event, the  
277           calculation appears to be incorrect.

278    23.    Q    How do you respond to IIEC witness Phillips assertion that the basic structure of the  
279           Demand Metered General Service class rates should not be changed in this case, and  
280           an equal percentage increase should be applied to all charges (IIEC Ex. 6, pp. 15-16)?  
281



304           A.     Regardless of whether the service has been declared competitive by the Commission,  
305                   the proper price signal still needs to be presented to customers. Comparing the marginal  
306                   (about \$0.20/kVAR) and embedded costs (about \$0.11/kVAR) indicate that new  
307                   customers, or customers with worsening power factors, would cause the Company to  
308                   install capacitors at a cost well above the embedded price that Mr. Stephens would  
309                   have customers pay. New customers or customers with worsening power factors  
310                   would receive the service well below the cost of incremental facilities, and in effect  
311                   would increase the total cost to all of the Company's customers. A better approach is  
312                   to send customers the correct price signal, based on cost of new facilities. This will lead  
313                   to customer choices that provide for a better use of resources. Existing customers will  
314                   not subsidize newer customers. Further, customers with a good power factor are not  
315                   harmful, and indeed may benefit, by using the Company's pricing methodology, since  
316                   revenue from reactive demand charges is used to offset the other demand charges as  
317                   outlined in IP Exhibit 6.10, schedule 2, item 3, page 6. This offset means that the  
318                   Company does not over-recover its total demand-related embedded cost revenue  
319                   requirement even though it bases reactive demand charges on the replacement cost of  
320                   capacitors.

321       26.     Q.     Mr. Stephens continues to maintain that the transformation charges for customers below  
322                   3 MW should be the same as the Transformation Charge for customers larger than 3  
323                   MW. (IIEC Ex. 4, p. 19) Please respond.

324           A.     In response to question 31 in my rebuttal testimony I discussed how costs for  
325                   transformation for customers above 3 MW can vary significantly. Conversely, the cost

326 of transformation for smaller customers is much less likely to exhibit cost variability.  
327 Transformation for smaller customers tends to be much more homogeneous. Smaller  
328 transformers are produced and purchased in bulk. Conversely, substation transformers  
329 used for large facilities are often produced to specific design parameters; they are more  
330 unique and often require significant lead-time to manufacture. If the Commission  
331 concludes that the Company's proposed \$0.75/kW transformation charge is  
332 unacceptable, then transformation service for customers above 3 MW should be  
333 eliminated and these customers should be required to either rent or own their  
334 transformation facilities, as was formerly the case. Rental or ownership enables the  
335 customer to customize the price for the service to the customer's circumstances.

336 27. Q. Please comment on Mr. Stephens' observation that the embedded cost of  
337 transformation is \$1.12/kW and that this level is different than the replacement cost.  
338 (IIEC Ex. 4, pp. 19-20)

339 A. The ECOS of \$1.12/kW is for all of the Company's transformation throughout its  
340 system. Many customers require use of transformation equipment that transforms  
341 power from transmission or subtransmission voltage down to the next lower voltage.  
342 For lower voltage customers, this is typically the primary voltage level. Customers will  
343 also require transformation from primary voltage down to the service voltage required  
344 by the customer. The ECOS calculation includes the costs of all transformation and  
345 substation equipment, producing a value that is not representative of the last segment of  
346 transformation that is required to provide service to the customer at the desired service  
347 voltage level. In contrast, the transformation charge is based on the cost of



348 transformation facilities required to convert power from the supply line voltage down to  
349 the voltage required by the customer.

350 **D. Standby Capacity Requirement**

351 28. Q. Mr. Stephens continues to oppose billing the standby customer three times the demand  
352 charge in the event that the customer's actual demand exceeds its standby capacity by  
353 more than 10%, and claims that his arguments in direct were never countered in  
354 rebuttal. (IIEC Ex. 4, p. 13) Do you agree?

355 A. No. Mr. Stephens' argument in his direct was that "Standby customers have adequate  
356 incentive to properly contract for standby capacity. If their generation fails, they need to  
357 be assured that there will be sufficient capacity available to serve their needs." (IIEC Ex.  
358 I, p. 18, lines 17-19) On page 21 of my rebuttal testimony at lines 439 – 441, I state  
359 that "Without the provision, the Company believes that customers would have an  
360 incentive to choose a standby capacity value that is lower than what their actual delivery  
361 service needs would be if their self-generation facilities went off-line." Put plainly,  
362 profit-motivated customers may have a tendency to provide a low initial estimate of  
363 standby capacity in the absence of a provision that imposes financial consequences for  
364 underestimation of the standby capacity requirement.

365 29. Q. Do you accept Mr. Stephens' suggestion that if the three times demand charge  
366 provision is approved, that the charge only apply to the demand in excess of the 10  
367 percent over the standby capacity level? (IIEC Ex. 4, p. 14, lines 1 -3)

368 A. Yes. This was our intent.

369 30. Q. What concerns do you have over Mr. Stephens' suggestion that the Company and

370 customers simply negotiate a standby capacity requirement rather than establish the  
371 customer's standby capacity requirement at the outset and then review and possibly  
372 reset it every twelve months? (IIEC Ex. 4, p. 14, lines 11-21)

373 A. My principal concern is that negotiations will be lengthy, impose an administrative  
374 burden and not result in an agreed outcome. Service may commence while negotiations  
375 continue resulting in retroactive adjustments to prior billings once resolution is reached.  
376 Therefore, I do not agree with Mr. Stephens' suggestion. Under IP's proposal, the  
377 Company accepts the customer's specification of its standby capacity requirements, but  
378 the customer is given a financial incentive to develop a reasonable estimate.

379 31. Q. Is Staff Witness Haas still opposed to the three times demand charge for exceeding the  
380 standby capacity requirements, even though you have added the 10% demand dead  
381 band?

382 A. Yes. Dr. Haas states that there is still too strong an incentive for the SG customer to  
383 overestimate standby requirements, and that the three times demand charge is arbitrary  
384 and not cost of service based. (Staff Ex. 18.0, pp. 2-3, lines 30-56)

385 32. Q. Please respond to Dr. Haas' criticisms.

386 A. First, contrary to Dr. Haas' assertion, the three times demand charge gives self-  
387 generation customers an incentive to accurately estimate and contract for the level of  
388 delivery services that they require the Company to be ready to provide on no notice.  
389 My discussion in response to Mr. Stephens also applies there. However, the 10%  
390 dead band protects the customer against reasonable estimating errors. Second, the  
391 three times demand charge is not intended to be cost based; it is intended to strongly

392           incent the SG customer to reasonably estimate its standby requirements. Such tariff  
393           provisions that are applicable in the event of a customer exceeding a stated contract  
394           amount are not new. For example, the Company's gas tariffs for demand metered  
395           customers (Service Classifications 65 & 76) contain a provision to charge customers an  
396           Excess MDQ Charge of three times the demand charge for the excess demand over a  
397           stated Maximum Daily Quantity. Similarly, IP's gas transportation tariffs (and those of  
398           other Illinois gas distribution companies) impose charges of \$6 per therm if the customer  
399           takes unauthorized overrun gas. Without the three times demand charge provision, SG  
400           customers would have an incentive to contract for low standby capacity levels. In the  
401           meantime, the SG customer would be a free rider on the IP delivery system by avoiding  
402           paying for facilities that were built to serve the customer.

403    33.    Q.    Has Dr. Haas commented on your proposal to apply a diversity factor to SG  
404           customers' Demand Charge? (p 5)

405           A.    Yes. Dr. Haas states that the proposal "could bring Demand Charges applied to SG  
406           customers to a point more in line with the Demand Charges that non-SG customers  
407           would pay based on their monthly non-coincident peak demand." (Staff Exhibit 18.0,  
408           page 5, lines 104-107) However, Dr. Haas points out additional concerns. Mr.  
409           Stephens, in contrast, states that IP's diversity factor proposal "is an improvement on  
410           IP's original proposal and should be accepted." (IIEC Ex. 4, p. 15)

411    34.    Q.    What is Dr. Haas' first concern?

412           A.    Dr. Haas states that "two SG customers with identical annual peak needs, but with SG  
413           units of differing reliability, will be charged the same amount of Demand Charges

414 regardless of the relative reliability of their units.” (Staff Ex. 18.0, pp. 5, 110-113)  
415 However, this is not a problem. The rate works that way by design. Dr. Haas believes  
416 that these customers should pay a different rate. However, if IP has a customer on one  
417 circuit with a generator that runs at a higher load factor, and another generator on a  
418 different circuit with a lower load factor, IP would not be prudent to reduce the  
419 investment (and load carrying capability) in the circuit with the higher load factor  
420 generator. (Keep in mind that IP has only 9 self-generation customers, spread across  
421 its system of nearly 800 distribution circuits. No two of these customers are served on  
422 the same circuit, so they provide no offsetting diversity benefits.) The Company has the  
423 responsibility to provide reliable service to all customers. To do so, the Company must  
424 plan the distribution circuit as if the SG customer’s generation is off line at the time of  
425 peak, or risk the possibility of an outage that impacts far more customers than the SG  
426 customer.

427 The fact that an SG customer’s actual demand in a year is less than its standby  
428 capacity does not matter. What matters is imposing a charge for standby capacity  
429 provided to SG customers that is commensurate with the costs they cause to be  
430 imposed on the distribution system if their generation is offline. The Company must  
431 stand ready to provide reliable delivery service to either customer in Dr. Haas’ example,  
432 with no notice, at any time of the year.

433 35. Q. What is Dr. Haas’ second concern?

434 A. Dr. Haas states that the Company’s proposal is insensitive to actual performance of a  
435 customer’s SG unit and thus does not reward SG as a means of peak-shaving relative

436 to other options. He says it also provides no incentive to the SG customer to shed load  
437 in the event of an SG outage, and encourages poor load profiles by SG customers.  
438 (Staff Ex. 18.0, pp. 5-7)

439 However, IP does not provide a "reward" to peak shaving SG customers  
440 because there are no benefits (cost reductions) to IP. While "a non-SG customer that  
441 reduces its non-coincident demand from one month to the next will see its Demand  
442 Charges reduced" (Staff Ex. 18.0, p. 6, lines 138-139), the non-SG customer will tend  
443 not to have the same degree of variability in month to month demands as the SG  
444 customers. Larger customers, and in particular industrial customers, tend to have a  
445 similar total demand each month. The Company must plan the delivery system to  
446 provide reliable service for the total coincident load for the circuit, which would include  
447 an estimate for a SG customer's expected possible demand in the event of an outage for  
448 the SG customer's generation.

449 Finally, Dr. Haas overestimates the impact of delivery services rates on the total  
450 customer economics of installing and operating SG. SG customers on delivery service  
451 are much more likely to be sensitive to non-delivery service issues such as the cost of  
452 fuel that runs the SG facility, or the market price of power they would have to purchase  
453 if the SG ran at a lower utilization rate.

454 36. Q. Please respond to the four choices that Dr. Haas claims would be improvements on  
455 IP's proposed treatment of SG customers with regard to allocation of demand charges.  
456 (Staff Ex. 18.0, pp. 7-10)

457 A. Dr. Haas' four choices are not improvements. Rather, they are mechanisms to allow

the SG customer to pay less than its fair share of the costs that it imposes on the system.

The “first choice” Dr. Haas offers would have all customers, SG and non-SG, face the same allocation methodology. This choice should be rejected for the reasons discussed above, and in my rebuttal testimony. The “second choice” would use each SG customer’s rolling 12 month average of its monthly non-coincident peak demands instead of its standby capacity. Again, this proposal should be rejected for the reasons discussed above and in my rebuttal testimony. The SG and non-SG customer are receiving the same level of service – no-notice access to the delivery system. Accordingly, each should pay an amount commensurate with the cost of the service that has been provided. The “third choice” proposes to use the SG customer’s rolling 12 month maximum demand, but adjusted to subtract, on a monthly basis, the demand registered by the customer’s SG unit meter at the time of the customer’s greatest total peak for the month. The “fourth choice” is very similar to the “third choice,” but instead of using the 12 month maximum demand, would use the customer’s contracted standby capacity, adjusted as described in the “third choice.” These mechanisms still allow the SG customer to pay less than its fair share of the costs that it imposes on the system. In months when the SG customer’s generation is running at the time of its peak, the customer will escape paying for distribution facilities that were built to serve him, and remain ready to serve him when his SG fails. Further, the proposal produces discriminatory demand values. Assume that the customer’s generation ran at the beginning of the month, but not at the end, and the customer’s total energy need remained at a daily peak of 5 MW, except for one day early in the month when peak

load was 5.01 MW. Assume that the customer has a 2 MW generator. Under Dr. Haas' proposal, the customer's demand charge billing would be based on 3.01 MW. However, later in the month, the customer actually needed, and used, 5 MW of delivery capacity, but only had to pay for 3 MW. This is a great deal for the customer, but is discriminatory and a subsidy. Dr. Haas' "load diversity factor" is similar to Company's proposed load diversity factor in name only.

37. Q. In the event that the Commission accepts Mr. Lazare's proposal to reject the Distribution Capacity Charge, how would the Company's proposed standby capacity charge be billed?

A. The Company's proposal would change only in that a Distribution Capacity Charge rate would not be applied to standby capacity. The Demand Charge would be applied to standby capacity.

38. Q. Does Dr. Haas offer suggestions concerning the billing for SG customers in light of Mr. Lazare's Distribution Capacity Charge recommendation?

A. Yes. Dr. Haas offers five choices. The first four are identical to those described above, and should be rejected for the same reasons as discussed above. The "fifth choice" would use the customer's 12 month maximum demand instead of standby capacity, but would not include a diversity factor. This methodology presents a technical problem and a theoretical problem. First the technical problem. If Mr. Lazare's proposal is accepted, costs proposed to be recovered in the Distribution Capacity Charge will shift over to the low voltage Delivery Charge. There will be no separate distribution charge. For low voltage SG customers, elimination of the diversity factor could make these

502 customers worse off than under the Company's proposal. The theoretical problem is  
503 that, while use of a 12 month maximum demand may provide results that are close to  
504 the standby capacity, it still does not bill for the amount of capacity that may be desired  
505 by the customer. While the 12 month maximum demand may provide a good starting  
506 point for developing a standby capacity, the initial standby capacity may be more or less  
507 than the customer's historical 12 month maximum demand. The Company's proposal  
508 allows the Customer to establish a demand level that fits the customer's view of the  
509 situation looking forward from today. The subsequent annual review for customers who  
510 exceed their pre-set value, allows the parties to revisit the standby demand level and  
511 establish a new one that is appropriate for both parties, if circumstances warrant.  
512 Further, Dr. Haas' proposed "diversity factor" creates an opportunity for customers to  
513 have delivered more kW than they would be required to pay for, as discussed in my  
514 previous answer.

515 39. Q. Did Dr. Haas comment on your hypothetical example presented on pages 25-26 of  
516 your rebuttal testimony?

517 A. Yes. Dr. Haas appears to be critical of the example, but states that "SG customer's  
518 twelve-month maximum demand would be a good substitute for its contracted standby  
519 capacity as a determinant for the applicable billing units for Distribution and  
520 Transformation Charges." (Staff Ex. 18.0, p. 17, lines 366-369)

521 However, Dr. Haas does not propose this as his "first choice" if the  
522 Commission were to accept Mr. Lazare's distribution capacity charge recommendation.  
523 The example highlights the shortcomings of adopting the "first choice" as presented by



524 Staff. Dr. Haas states that "overall, the example provided by Mr. Jones, while a good  
525 theoretical indication of what could go wrong, is an extreme example and it is not really  
526 relevant to the issues at hand." (Staff Ex. 18.0, p. 18, lines 389-392) However, the  
527 example does not have to exactly match the actual situation to bring light to the subject.  
528 The example illustrates how other customers subsidize the SG customer. Under Staff's  
529 combined rate design proposal, other customers will subsidize the SG customer.

530 40. Q. Dr. Haas disputes the "insurance" analogy (see IP Exhibit 6.6, lines 457-459), and  
531 provides a specific example using auto insurance to illustrate his point that SG customers  
532 with more reliable units would pay less. (Staff Ex. 18.0, p. 18-20) Is the automobile  
533 insurance analogy appropriate for distribution service?

534 A. No. Use of the auto insurance analogy is not descriptive of the situation at hand.  
535 Providing auto insurance presents a potentially unlimited risk to the insurance provider.  
536 A customer who reports too many accidents or gets too many tickets is at risk of being  
537 dropped by the insurance provider so as to limit the company's exposure to the high-  
538 risk customer. For IP, the risk imposed on the Company by the SG customer is that  
539 the customer uses the delivery system and contributes to the design peak of the circuit.  
540 Since the Company desires to provide safe and reliable service to customers, it attempts  
541 to build enough capacity in the circuit to serve the SG load. An SG customer that uses  
542 the delivery system once, twice, or 100 times in the year imposes the same cost on the  
543 Company. Frequency of use (claim) really doesn't matter. Further, Mr. Haas'  
544 revisions to the "insurance analogy" are inappropriate because a provider of auto  
545 insurance has extensive historical demographic and accident data to use in classifying its

thousands of customers into risk categories and pricing the insurance sold to customers in each class based on the levels of risk they present. In contrast, IP must plan and construct its distribution circuits to serve the load of an SG customer on that circuit whether the customer's SG unit is likely to be off-line once per year or ten times per year.

**E. Rider PRS**

41. Q. Mr. Stephens suggests that the Company modify its originally filed Rider PRS to either (i) provide for both the hourly pricing option (with modifications that he proposed in direct testimony) or use of the bundled tariffs, or (ii) approve Rider PRS to provide for both the original IP hourly pricing option and the use of the bundled tariffs. (IIEC Exhibit 4, p 25-26) Do you have any comments?

A. Yes. The Company was concerned that possible modifications to the original filed Rider PRS could result in substantial gaming opportunities relative to the Company's other bundled service offerings. Mr. Stephen's proposed modifications to Rider PRS, especially the inference that the 10% adder to market price be changed or eliminated, were unacceptable to the Company. Further, Mr. Stephens' second solution, to have the Company offer Rider PRS as originally filed and offer the option to utilize bundled service tariffs, still allows for gaming opportunities, and is therefore unacceptable to the Company. Therefore, the Company is withdrawing its proposed ~~Rider~~ <sup>Rider</sup> PRS.

**F. Rate Design for Revenue Requirement Different than that Proposed in Rebuttal**

567 42. Q. Since the final approved, revenue requirement is likely to differ from that used to  
568 develop the Company's proposed rates that were submitted with your rebuttal  
569 testimony, what guidelines should the Commission use to develop alternate rates to  
570 recover the final revenue requirement?

571 A. The residential facilities charge should remain unchanged at a level equal to the  
572 proposed SC 2 facilities charges that will be in effect on May 1, 2002. The delivery  
573 charge should be set to recover the remaining residential revenue requirement, with the  
574 first 300 kWh priced at a rate 1.4 cents/kWh higher than the rate for usage over 300  
575 kWh/month. For the non-residential rate design, the Commission should use the rate  
576 design methodology presented in IP Exhibit 6.10. The combined facilities and metering  
577 charges for non-residential service should be set at a level that is one-half way between  
578 the current delivery service price and the cost of service. The resulting subsidy should  
579 be applied to help soften the impact of moving to strictly cost-based demand charges,  
580 as shown in IP Exhibit 6.10. The sole exception is the Unmetered facilities charge,  
581 which should remain at \$8.50/month. The remaining revenue requirement for  
582 Unmetered customers should be recovered through the Unmetered delivery charge.  
583 The charges for transformation and reactive demand should remain as proposed.  
584 However, if changes to these charges are made, the resulting price changes to other  
585 demand charges as shown in IP Exhibit 6.10 should be made. Lighting rates should  
586 simply be scaled up or down to meet the new revenue requirement target for the  
587 Lighting Class.

588 43. Q. Does this conclude your prepared rebuttal testimony?

589 A. Yes it does.